SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Kuehl and Wildman Analyst: Jeani Brent Bill Number: AB 484

Related Bills: See Prior Analysis Telephone: 845-3410 Amended Date: 05/28/1999

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Employer Qualified Production Labor Contract for Production of Television or Movie Credit/FTB Report to Legislature Regarding Total Credits Claimed

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _________.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

X AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended April 5, 1999 .

X FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO___.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 5, 1999 , STILL APPLIES.

X OTHER - See comments below.

SUMMARY OF BILL

This bill would allow taxpayers engaged in the production, development or distribution of certain motion picture and television production to claim a credit equal to 10% of specified production labor contract costs of qualified property.

This bill also would require the department to annually report to the Legislature on the total amount of credits claimed under the bill and would require the Employment Development Department (EDD) to annually report to the Legislature employment data for Standard Industrial Classification Code 781 (relating to motion picture and videotape production). The provisions regarding EDD are not discussed in this analysis.

SUMMARY OF AMENDMENT

The May 28, 1999, amendments changed the sunset date from January 1, 2007, to January 1, 2001, making it a one-year credit. In addition, the May 28, 1999, amendments increased the amount of the credit from 6% to 10% of the qualified cost of qualified property. Finally, the May 28, 1999, amendments removed credit carryover language that is unnecessary because a similar provision exists elsewhere in the law.

The May 10, 1999, amendments changed the operative date from January 1, 1999, to January 1, 2000; provided that the employee must be hired on or after January 1, 2000; removed the provision that would have made the credit refundable; provided that the credit may be carried over indefinitely; included a sunset date of January 1, 2007; and provided that taxpayers may elect the credit under this bill in lieu of any other credit that may be allowable for the same costs.

Board Position:			Department/Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR		
____ N	____ OUA	X PENDING	**Johnnie Lou Rosas**	**6/10/1999**

The May 10, 1999, amendments also added the requirement for the department to annually report to the Legislature on the total amount of credits claimed.

The amendments resolved several policy considerations and resolved the implementation considerations regarding the refundable provisions, but raise an additional policy consideration, identified as #3 below, and an additional implementation consideration, identified as #5 below. The remaining policy and implementation considerations are repeated below.

Except for the above discussion, the policy and implementation considerations, and revenue estimate, the department's analysis of the bill as amended April 5, 1999, still apply. The Board position remains the same and is included below for convenience.

POLICY CONSIDERATIONS

This bill would raise the following policy considerations.

1. This bill defines "qualified property" as either movies of the week or pilots. This definition appears to exclude ongoing television programs.

2. Conflicting tax policies come into play whenever a credit is provided for an expense item for which preferential treatment is already allowed in the form of an expense deduction. This bill would have the effect of providing a double benefit for deductible wages and salaries. On the other hand, making an adjustment to limit deductions in order to eliminate the double benefit creates a state and federal difference, which is contrary to the state's general conformity policy.

3. When expenditures qualify for more than one credit, recent legislation has replaced language requiring taxpayers to make an election for those expenditures with a provision limiting the taxpayer to only one credit with respect to qualified expenditures. This change allows taxpayers to make the choice of which credit to take on either the original or an amended return. The qualified property credit under this bill would require taxpayers to make an election on the original return. Once made, an election is binding and generally cannot be revoked. In addition, with an election provision, the failure to make an election generally constitutes an election out of the provision, and this "non-election" also is binding.

IMPLEMENTATION CONSIDERATIONS

This bill would raise the following implementation considerations.

1. This bill would define "qualified cost" as any production labor contract that is capitalized in the production, development, or distribution of a motion picture. Since the costs are tied to a "production labor contract," the bill leaves unclear whether "qualified costs" include only those costs associated with production or includes costs also associated with development and distribution.

2. This bill defines a "qualified taxpayer" as one engaged in the production, development, or distribution of a motion picture or television production. The bill leaves unclear how a taxpayer who merely develops or distributes, but

does not produce, a film, could incur “qualified costs,” if “qualified costs” include only those costs associated with a production labor contract.

3. The terms “production labor contract,” “production, development and distribution,” and “equity” are not defined. For example, the use of "equity" in discussing how a credit would be shared among taxpayers is unclear and may cause disputes between taxpayers and the department.

4. This bill states that a credit would be allowed for the qualified cost for qualified property. However, the credit in this bill is not a credit for "qualified costs for qualified property" — rather, the credit fundamentally is comparable to a "wage credit" for amounts paid for the services on an employee under a labor contract to produce certain motion pictures and television shows. It would help the department in administering this credit if the terminology were changed to reflect this fact to clarify the nature of payments eligible for the credit.

5. This bill would provide an unlimited carryover of excess credit amounts. Credits with unlimited carryovers must be maintained on tax forms and systems even when the credit has expired. Since tax credits usually are used within eight years, most recently enacted credits contain limited carryover provisions, generally eight or ten years.

REVENUE ESTIMATE

The revenue impact of this bill is estimated to be as shown in the following table:

Revenue Impact of AB 358, As Amended May 28, 1999 Assumed Enacted after June 30, 1999 $ Millions		
1999-0	2000-1	2001-2
-$13	-$40	-$26

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

TAX REVENUE DISCUSSION

The revenue impact of this credit would depend on the amount of qualified wages paid and the tax liabilities of employers claiming this credit.

The amount of qualified wages is estimated as the product of the number of qualified newly-hired employees and the average wage. The number of qualified employees was estimated from data provided by the EDD. According to EDD, total employment for SIC Code 781 (Motion Picture and Video Tape Production) was 143,300 in 1998.

EDD also provides average weekly earnings for people employed in SIC Code 78 (Motion Pictures). EDD data also reveals that the average annual growth rate of employment in SIC 78 was 6.6% and weekly wages was 6.6% for the period 1995 through 1998. These growth rates were used for projecting total employment and average weekly earnings for SIC 781 for the out years of this bill. Annual labor turnover rate is assumed to be 20% of total employment. The number of qualified employees for the year 2000 is estimated as the sum of new and replaced employees discounted by 69% to account for collective bargaining requirement, officers' salaries, $5 million cost limit, and the fact that not all new employees are hired on the first day of the year.

For the year 2000, total employment for SIC 781 is estimated as 162,840 (143,300 * 1.066 * 1.066). The number of qualified employees is estimated as 12,639 as follow:

(10,082 new employees + 30,552 replaced employees)*(1-0.69) = 12,639

From this data it is calculated that qualified wages paid in California for workers within SIC 781 amounted to $928 million in 2000 (12,639 qualified employees in 2000, at $1,468 per week for 50 weeks).

The revenue loss for 2000, the first taxable/income year, is projected to be $70 million as follow:

$928 mil. in qualified wages*10% credit rate*75% utilization rate = $70 mil.

It should be noted that even though this credit is effective for only one year, 2000, its revenue impact is estimated to spread to more than one year. This is due to the fact that some taxpayers would have to carry over unused credits to succeeding years, and that many fiscal filers will not fully claim this credit until the year 2001/2002.

BOARD POSITION

Pending.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill, as introduced February 18, 1999. The Franchise Tax Board's position for the bill as amended is pending.